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KMC Telecom, Inc.
Ameritech § 271 Application
Michigan

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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JUN 10 1997

*Federal Communications Commission
Office of Secretary*

In the Matter of)
)
Application of Ameritech Michigan)
Pursuant to Section 271 of the)
Telecommunications Act of 1996 to)
Provide In-Region, InterLATA Services)
in Michigan)

CC Docket No. 97-137

**OPPOSITION OF KMC TELECOM, INC.
TO APPLICATION OF AMERITECH MICHIGAN
TO PROVIDE INTERLATA SERVICES IN MICHIGAN**

Russell M. Blau
Mary C. Albert
Robert V. Zener
SWIDLER & BERLIN, CHARTERED
3000 K Street, N.W., Suite 300
Washington, DC 20007-5116
Phone: 202-424-7500
Fax: 202-424-7643

Counsel for KMC Telecom, Inc.

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SUMMARY

1. Granting Ameritech interLATA authorization would not be consistent with the public interest, since local exchange competition in Michigan has not even come close to the point of breaking Ameritech's "bottleneck" control of the local exchange market. InterLATA authorization would be premature, since it would destroy Ameritech's incentive to cooperate in the creation of a competitive local exchange market in Michigan.

2. Ameritech has not shown that its interconnection rates comply with the Act's cost-based pricing standard. The Michigan Commission's approval of interim rates was based on its finding that Ameritech's revised cost studies were not as defective as its previous studies had been. But the Michigan Commission did not find that Ameritech's revised studies complied with the Act. The checklist requires compliance with the Act. While approval of rates without a finding of compliance with the Act may have been valid for interim purposes, the interLATA entry Ameritech seeks would be permanent and thus cannot be justified by the relaxed standards of proof that might justify interim findings.

3. Ameritech and its long-distance affiliate do not meet the "separate directors" requirement of section 272. The fact that they have no directors does not exempt them from this requirement. Congress wanted the operating company and its long-distance affiliate to have separate governing bodies. Here, they are both wholly-owned subsidiaries of the same holding company and thus, lacking their own boards, are both governed by the parent's board of directors, in plain violation of section 272.

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**OPPOSITION OF KMC TELECOM, INC.
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KMC Telecom, Inc. ("KMC") is a new provider of competitive access and local exchange service throughout the nation. The Michigan Public Service Commission has granted KMC authority to provide facilities-based and resold local exchange service in Michigan. As a potential provider of local exchange service in Michigan, KMC is concerned that a premature granting of interLATA authority to Ameritech Michigan will eliminate that company's incentive to cooperate with KMC in providing the interconnection and unbundled network elements that KMC will require to compete in the Michigan local exchange market.

I. INTERLATA AUTHORIZATION WOULD BE PREMATURE AND CONTRARY TO THE PUBLIC INTEREST.

Section 271(d)(3)(C) of the 1996 Act requires the Commission, before granting interLATA authorization, to find that the BOC complies with the competitive checklist "and" that interLATA authorization is "consistent with the public interest, convenience, and necessity." The legislative history makes it clear that Congress' use of "and" was intentional: there was a clear intent that compliance with the checklist would not be enough -- that interLATA

authorization required a “public interest” finding in addition to checklist compliance.¹

Accordingly, even if Ameritech had complied with the checklist (and we do not believe it has), it is not entitled to interLATA authorization absent a “public interest” finding.

As Ameritech correctly points out, the words “public interest” as used in regulatory legislation are not “a broad license to promote the general public welfare,” but rather “take meaning from the purposes of the regulatory legislation.” NAACP v. Federal Power Comm’n, 425 U.S. 662, 669 (1976), quoted in Ameritech Brief at 62. In this case, Ameritech’s application fails not because of some overall concept of “general public welfare,” but because it fails to meet the “public interest” standard as defined in the Act itself and its legislative history.

The specific content of the “public interest” standard as used in § 271 is illuminated by § 271(d)(2)(A), which requires the Commission to consult with the Attorney General. Consultation with the Attorney General serves as a basis for assessing competitive considerations, which are pertinent to the “public interest” determination. The legislative history establishes that Congress expected one basis for assessing competitive considerations to be section VIII(C) of the MFJ -- which adopts the standard that there must be no substantial

¹ The Senate bill contained the requirement of a “public interest” finding. S. 652, § 255(c)(2). This was criticized on the ground that the “Bell companies having satisfied the ‘competitive checklist,’ they should be allowed to compete then, not at some indefinite future time. Their ability to compete should also not be subject to an ill-defined ‘public interest’ finding by the Federal Communications Commission.” S. Rep. No. 23, 104th Cong. 1st Sess. at 62 (Additional Views of Senator Burns)(emphasis added). By contrast, the House bill contained no public interest test, and was criticized on the ground that it might allow interLATA entry by the regional Bells before there is “real competition in the local business and residential markets.” 141 Cong. Rec. H8458 (daily ed. Aug. 4, 1995)(Rep. Bunning). The Conference Committee, in light of these conflicting concerns, opted for the Senate’s “public interest” provision. House Conf. Rep. No. 458, 104th Cong. 1st Sess. at 161.

possibility that the BOC or its affiliates could use monopoly power in the local exchange market to impede competition in the interLATA market. House Conf. Rep. No. 104-458, 104th Cong. 2d Sess. at 149. That standard required an assessment of competitive conditions in the local market, to determine whether the BOC continued to possess “bottleneck” monopoly power that it could leverage into market power in the interLATA market. United States v. Western Electric Co., 673 F. Supp. 525 (D.D.C. 1987), aff’d 900 F.2d 283 (D.C. Cir. 1990).

At present, competition has made only a minuscule dent in Ameritech’s bottleneck control of the local exchange market in Michigan. Competitors’ sales at present are a tiny percentage of local exchange revenue in Michigan, and there are large areas of the State where there is no competitive presence. Even the competitors presently in the market are overwhelmingly dependent on reselling Ameritech services or utilizing Ameritech’s network. Unless and until competitors lose that dependence and acquire more than just a token presence in the market, the local exchange market cannot be determined to be sufficiently competitive to break the local exchange “bottleneck.”

Ameritech argues that Congress refused to write into the statute a “metric test,” requiring local competition to reach a specified level before the BOC is admitted into the interLATA market. Ameritech Brief at 63 n. 77. However, Congress did require a “public interest” finding. Congress’ refusal to include in the checklist a requirement that local competition meet a specific threshold does not preclude the Department of Justice and the Commission from considering the actual level of competition as one element in the overall determination of whether granting the BOC’s application would be consistent with the public interest.

At present, the only real incentive for Ameritech and the other BOCs to provide adequate

implementation of access and interconnection is the knowledge that they must do so to gain interLATA authorization. Once that authorization is granted, the incentive will disappear. The Commission should make it clear that interLATA authorization will not be granted until it has been clearly demonstrated that access and interconnection are working in actual practice, and that as a result competition has developed to more than just a token level. Until that happens, “public interest” considerations dictate that interLATA authorization be withheld.

II. THE MICHIGAN COMMISSION’S APPROVAL OF INTERIM NETWORK ELEMENT RATES WITHOUT ADEQUATE COST STUDIES DOES NOT COMPLY WITH THE CHECKLIST, AND IS ANOTHER REASON WHY INTERLATA AUTHORIZATION WOULD NOT BE CONSISTENT WITH THE PUBLIC INTEREST

1. The Michigan Commission’s Findings Approving Interim Rates Were Not Sufficient For Purposes of Establishing Checklist Compliance.

In addition to meeting the “public interest” requirement, Ameritech must demonstrate compliance with the competitive checklist. It has failed to do so. The competitive checklist requires the BOC to provide interconnection and access to network elements “in accordance with the requirements of sections 251(c)(3) and 252(d)(1).” § 271(c)(2)(B)(i), (ii). These provisions, in turn, require the pricing of interconnection and network elements to be “based on the cost . . . of providing the interconnection or network element.” § 252(d)(1)(A)(i). Under this standard, prices must be based on cost studies found to comply with the Act. The prices approved in Michigan are not.

To demonstrate that its rates comply with the Act, Ameritech relies on the Michigan Commission’s decisions approving the interconnection agreements it signed with AT&T and

Sprint following arbitration. Ameritech Brief at 16. Specifically, Ameritech relies on the finding the Michigan Commission made in approving each agreement that “the agreement is consistent with federal and state law, and is in the public interest.” Ameritech Brief at 16 n. 15, quoting Opinion and Order, Case Nos. U-11151/U11152, pp. 5-6 (Mich. Pub. Serv. Comm’n) (April 4, 1997), and Opinion and Order, Case No. U-11203, pp. 3-4 (Mich. Pub. Serv. Comm’n) (April 4, 1997).²

However, for both agreements the Michigan Commission’s finding of compliance rested solely on its decision in the AT&T arbitration.³ In that arbitration, the Michigan Commission approved the Arbitration Panel’s recommendation to adopt rates based on AT&T’s cost studies, until such time as Ameritech submitted revised studies in Dockets U-11155 and U-11156, at which time the Ameritech rates were to be substituted.⁴ Two weeks later, on December 12,

² The Michigan Commission orders approving these agreements are found in the Application at Vol. 1.2. p. AM-1-020273 (AT&T) and Vol. 1.5, p. AM-1-050264 (Sprint).

³ The Michigan Commission’s order of April 4, 1997, approving the AT&T agreement contains no analysis of the cost basis of the rates set forth in the agreement, and thus must be presumed to rest on the findings in its prior arbitration decision. See Order of April 4, 1997, Application Vol. 1.2, p. AM-1-020273. The Michigan Commission’s approval of the Sprint Agreement was explicitly based on the rates established in the AT&T Arbitration. See Order of April 4, 1997, at pp. 1-2, Application Vol. 1.5, p. AM-1-050264.

⁴ Petition of AT&T Communications of Michigan, Inc. for arbitration to establish an interconnection agreement with Ameritech Michigan, Case Nos. U-11151, 11152, Order Approving Agreement Adopted by Arbitration (November 26, 1996) at pp. 7-8. A copy of this decision appears in the Application at Vol. 1.2 pp. AM-1-020003 et seq. The Arbitration Panel’s recommendation, which the Commission adopted, was that “should a determination be reached by this Commission on the [Ameritech] TSLRIC studies pending in Case Nos. U-11155, U-11156 and Ameritech Advice No. 2438B to support different pricing conclusions for services addressed in this proceeding, it would be appropriate to reflect these altered prices in the parties’ interconnection agreement.” Arbitration Panel Decision at p. 16. See Application at Vol. 4.1 pt. 8, p. AM-4-003645

1996, the Commission issued an order in Dockets U-11155 and U-11156 approving Ameritech's revised TSLRIC studies "for use, on an interim basis," and the rates in the AT&T and Sprint agreements were revised accordingly. See Application Vol. 4.1 p. AM-4-004071. Ameritech must rely on the Michigan Commission's order of December 12, 1996 to establish that its prices for unbundled elements are "based on cost" as required by the Act and the checklist.

But the Michigan Commission's order of December 12, 1996 makes no finding that Ameritech's revised cost studies comply with the Act. Instead, the Commission found only that Ameritech's revised studies were not as defective as its prior studies had been. Specifically, the Commission decision cited its Staff's criticism of Ameritech's proposed computation of fill factors,⁵ as well as Staff's statement that "vastly different loop costs and prices have been requested (and, in some cases, approved for use) by Ameritech Michigan in [five] proceedings over the last two years." Application Vol 4.1 p. AM-4-004069. The Commission then described its Staff's recommendation to 1) initiate a proceeding to study the pertinent TSLRICs, and 2) establish interim rates based on Ameritech's revised TSLRIC studies because "[d]espite their flaws, . . . these cost studies more closely follow the TSLRIC methods required by the Act and past Commission orders than any others submitted by Ameritech Michigan over the last two years." Id. at AM-4-004069-004070. The Commission then approved its staff recommendation to initiate a new TSLRIC proceeding, and to adopt interim rates based on the TSLRIC studies then on file:

⁵ "The Staff asserts that insufficient information was offered to support a change in the fill factors applied to Ameritech Michigan's retail services. The Staff further contends that fill factors based on actual results or used to reflect stranded investment are not forward-looking." Application Vol. 4.1 at AM-4-004068-004069.

[T]he Commission finds that interim rates should be established in order to avoid further delaying the extension of competitive options to customers in Ameritech Michigan's service territory. Moreover, it agrees with the Staff that the most appropriate basis for those rates is the TSLRIC study submitted in conjunction with the amended applications in Cases Nos. U-11155 and U-11156. Although flaws still exist, the studies now at issue in these cases more closely correspond to the methodology required by the Act and prior Commission orders than those submitted previously.

Id. at AM-4-004070 (emphasis added). This falls far short of a finding that Ameritech's revised studies comply with the Act. Indeed, the "flaws" to which the Commission refers were quite serious. The Staff criticism of Ameritech's computation of fill factors was a significant matter (see note 5 supra), as were the various criticisms raised by the other parties to the proceeding and described in the Commission's decision.⁶ There is nothing in the Commission's decision to indicate that it disagreed with any of these criticisms or regarded the "flaws" in Ameritech's revised studies to be minor. Instead, the Commission makes it plain that its reason for accepting the flawed studies was its desire "to avoid further delaying the extension of competitive options" to Michigan customers. Id.

The Michigan Commission's approach may well have been valid in the context of an interim rate proceeding. As this Commission has pointed out, where the purpose of a proceeding is to set interim rates only and adequate cost studies do not exist, State Commissions may take action on the basis of less than adequate data, particularly when faced with the strict time limits of the Act. Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order, ¶ 767. This approach is supported

⁶ The Commission's decision describes the criticisms at AT&T, MCI, the MCTA and the Michigan Attorney General. Application Vol. 4.1 at AM-4-004067-004068.

by judicial decisions holding that where a regulatory commission “lack[s] the data necessary,” it may approve rates not affirmatively found to be unlawful, provided its approval is limited to a “reasonable interim period” pending establishment of a “more permanent rate structure.” MCI Telecommunications Corp. v. FCC, 712 F.2d 517, 535 (D.C. Cir. 1983).

However valid this approach may be for an interim decision, it does not suffice where the issue is the terms and conditions of RBOC entry into the interLATA market. Ameritech is not asking for “interim” entry. If Ameritech’s application is granted, the decision will be permanent for all practical purposes. Accordingly, before approving interLATA entry, the Commission needs to find that the access and interconnection rates are “based on cost” as required by the Act.

For the Commission to insist on a finding of compliance with the Act, despite the Michigan Commission’s decision approving rates on an interim basis, would in no way alter the competitive checklist or add additional requirements. It would simply recognize that where the Commission is asked to make a permanent rather than an interim decision, a higher standard is required.⁷ The Act requires a finding that Ameritech’s rates are “based on cost.” That requirement is simply not satisfied by a finding that Ameritech’s revised cost studies are not as bad as its previous studies.

It is significant that in this case Ameritech’s previous TSLRIC studies were way out of

⁷ Michigan’s establishment of interim rates, without approved cost studies, must rest on the relaxed standard of proof applicable to interim decisions. MCI Telecommunications Corp. v. FCC, *supra*. A party cannot obtain the benefit of a prior administrative or judicial decision, in a subsequent case where the party “has a significantly heavier burden than he had in the first action.” Restatement (Second) of Judgments, § 28(4). Here, Ameritech’s burden of establishing compliance with the pricing element of the checklist is significantly heavier than the burden either party had in the prior proceeding establishing interim rates, since authorization of entry into the interLATA market is not an interim decision.

line -- proposing loop rates ranging from 25% to 65% higher than the rates the Michigan Commission eventually accepted.⁸ In effect, Ameritech has now succeeded in getting the Michigan Commission to accept its defective studies, on the basis that its previous studies were even more defective. That is not a basis for finding compliance with the Act.

In its comments on Ameritech's previous application, the Michigan Commission argued that interim rates are a valid basis for satisfying the requirements of the Act, on the ground that "[e]xisting rates are always subject to review" and "[r]evision to any service price is commonplace and a characteristic of the marketplace." Comments of February 5, 1997 at p. 13; Application Vol. 4.1 at p. AM-4-003511. But even if that argument is right, the interim rates must still satisfy the checklist, and that includes the requirement that rates for network elements be "based on cost." In this case, there is simply no finding that Ameritech's rates are "based on cost." Absent such a finding, no rate -- whether interim or final -- can be found to comply with the checklist.

2. The Public Interest Finding Cannot Be Made Where Competitive Entry Decisions Must Be Made in Light of the Uncertainty Inherent in Interim Interconnection Rates Established Without Adequate Cost Studies.

Even if the Michigan Commission's approval of interim interconnection and network element prices were considered dispositive with respect to compliance with the pricing element of the checklist, that would not be the end of the matter.

Under any definition of the Act's "public interest" standard, the Commission must

⁸ In the AT&T arbitration, Ameritech's proposed rates for Zones A, B and C were \$15.61, \$18.48 and \$21.33, which the Arbitration Panel found to be "unreasonably high." See Decision of Arbitration Panel (October 28, 1996) at 8, Application Vol. 4.1 at AM-4-003637. The interim rates finally accepted by the Michigan Commission were \$9.31, \$11.84 and \$14.67.

consider whether, in the circumstances of the particular case, compliance with the checklist is sufficient to open the local exchange market to competition. Here, until Ameritech has presented adequate cost studies which the Michigan Commission has reviewed and approved, there can be no certainty as to what the permanent rates will be in Michigan for interconnection and unbundled elements.

In the recent past, Ameritech has advocated rates dramatically higher than the interim rates approved by the Commission. See note 8 supra. It must be assumed that Ameritech will continue to press for higher rates. Until the Michigan Commission adopts rates on the basis of cost studies found to comply with the Act, there will remain very significant uncertainty over what rates new entrants will have to pay, casting a cloud over the investment decisions that must be made before the Michigan local market can become competitive. The cloud will exist not because of market fluctuations, but because of a regulatory failure to make the findings required by law. Until that cloud is removed, the local market is not truly open to competition, since potential entrants considering investments in the local market are faced with the prospect that the present interim rates will be significantly altered. In the face of this level of uncertainty, interim rates that are not based on approved cost studies are simply not a sufficient basis for the type of investment decisions needed to create true, facilities-based competition in the local market.

III. AMERITECH HAS NOT MET THE SEPARATENESS REQUIREMENT OF SECTION 272.

Section 271(d)(3)(B) provides that the Commission shall not grant interLATA authorization unless it finds that, among other things, “the requested authorization will be carried

out in accordance with the requirements of section 272.” Section 272 requires interLATA services to be provided through a separate affiliate, which meets several requirements including a requirement to have “separate officers, directors, and employees from the Bell operating company of which it is an affiliate.” § 272(b)(3). Ameritech has failed to meet the requirement of “separate directors.”

Ameritech’s Brief states that “ACI [its long-distance affiliate], like all of the Ameritech Bell operating companies, currently has no board of directors.” Brief at 57. The supporting affidavit simply says that “Neither ACI nor any of the [Ameritech operating companies] currently has a board of directors. Thus, no director of ACI is also a director of an [Ameritech operating company].” Affidavit of Patrick J. Earley, ¶ 19, Application Vol.2.2. The supporting affidavit also asserts that no director of ACI “will concurrently be an officer, director or employee of an [Ameritech operating company].” Earley Aff., ¶ 21.

That is plainly insufficient. Ameritech apparently believes that Congress merely prohibited overlapping directors. If that were all Congress required, then having no directors at all would be adequate. But Congress did more; it required “separate directors.” The requirement to have “separate directors” is not satisfied by having no directors at all.

Nor is the purpose of the Act satisfied. Congress wanted the long-distance affiliate and the operating company to have separate governing bodies. That purpose is not achieved by having no board of directors at all -- thereby subjecting the two companies to direct shareholder control by their common parent.

Both Ameritech Michigan and ACI are wholly-owned subsidiaries of Ameritech Corporation. Since these subsidiaries have no board of directors -- and since Ameritech has not

explained what the alternative management arrangement is -- the Commission must assume that both subsidiaries operate by direct stockholder management.⁹ In these circumstances, the shareholders are the de facto directors; and since Ameritech Michigan and ACI have the same shareholder -- Ameritech Corporation -- they do not have "separate directors" and are not in compliance with § 272(b)(3).

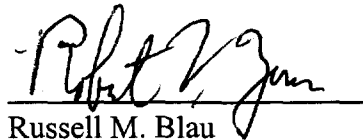
The "separate directors" requirement is one of several requirements designed to enhance the probability that the long-distance company and its affiliated BOC deal at arms length with each other and not engage in anticompetitive discrimination or cost shifting. Non-Accounting Safeguards Order, ¶ 9. Congress deliberately decided not to allow the Commission to waive these requirements, substituting a "sunset" provision for the waiver provision that had been contained in the Senate bill. House Conf. Rep. No. 104-458, at 152. Congress decided that the separateness requirements of section 272 were so important that it made them non-waivable. Ameritech is in violation of the language and purpose of at least one of those requirements, and its violation cannot be waived.

⁹ See Zion v. Kurtz, 50 N.Y.2d 92, 101, 428 N.Y.S.2d 199, 203 (1980), explaining that under Delaware law, the shareholders of a close corporation may "take[] all management functions away from the directors," in which case the corporation "operate[s] by direct stockholder management." See also 5 Fletcher, Cyclopedia Corporations (1996) § 2097 p. 461: the effect of a provision of the articles of incorporation limiting the authority of the board of directors is "to make the shareholders liable for managerial acts or omissions to the extent the corporation is controlled pursuant to that provision."

CONCLUSION

Ameritech's application violates sections 271 and 272 and is inconsistent with the public interest. It must be denied.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Robert V. Zener", is written over a horizontal line.

Russell M. Blau
Mary C. Albert
Robert V. Zener
SWIDLER & BERLIN
3000 K Street, N.W., Suite 3000
Washington, D.C. 20007-5116
Phone: 202-424 7500
Fax: 202-424-7643

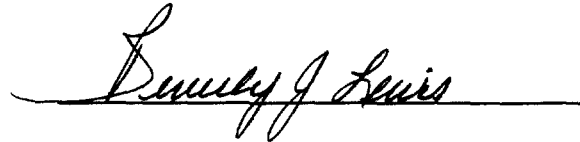
Counsel for KMC Telecom, Inc.

June 10, 1997

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing Opposition of KMC Telecom, Inc. To Application of Ameritech Michigan to Provide InterLATA Services in Michigan have been served this 10th day of June 1997 by first class mail, postage prepaid, or by hand delivery (indicated by an asterisk) to each on the attached mailing list.

A handwritten signature in cursive script, reading "Denny J. Lewis", is written over a horizontal line.

Department of Justice *
c/o Donald J. Russell
Telecommunications Task Force
Antitrust Division
555 - 4th Street, N.W., Room 8205
Washington, DC 20001

Kelly R. Welsh John T. Lenahan
Michael J. Karson Larry A. Peck
Gary L. Phillips
AMERITECH CORPORATION
35 South Wacker Drive
Chicago, IL 60606
|||||

John Gockley
AMERITECH COMMUNICATIONS, INCORPORATED
9525 West Bryn Mawr
Rosemont, IL 60018
 |||||

**Kenneth S. Geller
Mark H. Gitenstein
MAYER, BROWN & PLATT
2000 Pennsylvania Avenue, N.W.
Washington, DC 20006**

ITS, Inc. *
1231 - 20th Street, N.W.
Washington, DC

Ronald E. Russell
Commissioner
Public Service Commission
6545 Mercantile Way
P.O. Box 30221
Lansing, MI 48909
|||

John M. Dempsey
Craig A. Anderson
AMERITECH MICHIGAN
444 Michigan Avenue
Detroit, MI 48226
|||||

Stephen M. Shapiro
Douglas A. Poe
Christian F. Binnig
MAYER, BROWN & PLATT
190 South LaSalle Street
Chicago, IL 60603

Theodore A. Livingston
John E. Muench

Antoinette Cook Bush
Mark C. Del Bianco
SKADDEN, ARPS, SLATE, MEAGHER & FLOM
1440 New York Avenue, N.W.
Washington, DC 20005